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DATE: August 7, 2003

TO: Honorable Mayor and City Council

FROM: City Attorney

SUBJECT: Potential conflict of interest by Mayor or Council members enacting ordinances affecting the San Diego City Employees Retirement System

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MEMORANDUM OF LAW

QUESTION PRESENTED

Does a disqualifying conflict of interest exist because the Mayor and City Council members vote on ordinances affecting the San Diego City Employees Retirement System (SDCERS), of which the Mayor and Council are members?

SHORT ANSWER

The Mayor and City Council members (collectively "Council members") are not disqualified from voting on ordinances which affect the SDCERS because, pursuant to exceptions in the Political Reform Act ("PRA"), Council members do not have a disqualifying financial interest. Further, pursuant to both common law and the PRA, the "rule of necessity" prevents a disqualifying conflict.

DISCUSSION

1. Background

Pursuant to the San Diego City Charter ("Charter"), the City Council, which is composed of nine Council members and the Mayor (Charter section 12(a)) is "fully empowered . . . to enact any and all ordinances necessary . . . to carry into effect the provisions of" Charter Article IX, which regards the SDCERS, and that "any and all ordinances so enacted shall have equal force

and effect with [the] Article . . . .” Charter § 146. Therefore, all initial changes to the SDCERS are made by Council, although pursuant to Charter section 143.1, any ordinance passed by Council which ultimately amends the SDCERS must also be adopted by a majority vote of all members of the system.

Pursuant to San Diego Municipal Code (“SDMC”) section 24.0103, the Mayor and Council are defined as “elected officers” for purposes of the SDCERS. A separate retirement plan for elected officers has been established within the SDCERS pursuant to SDMC section 24.1701, which states in part:

> [T]here is established within this Retirement System a separate retirement plan for those present and future Elected Officers who become Members of this System and who are not otherwise entitled to benefits from this System for the period of service under consideration. Elected Officers who become Members of this System shall be entitled to all of the privileges and benefits of other Members of this System except as specifically provided in the section of the Municipal Code describing the benefit.

An elected officer's membership in the SDCERS is permissive, not mandatory, pursuant to SDMC section 24.1702. For purposes of this memorandum, it is presumed that the Mayor and all Council members are in fact members of the SDCERS. Therefore, any ordinance voted on by Council which affects the system also affects the Mayor and Council members' respective retirement benefits. Does a conflict of interest exist here? A disqualifying conflict does not exist, as explained below.

2. Conflict of interest

Conflict of interest statutes exist to prevent or limit the possibility of personal influence entering into decisions made by public officials. *(See generally*, Cal. Gov't Code § 81001 regarding the PRA, discussed below; *see also*, *Thorpe v. Long Beach Community College Dist.*, 83 Cal. App. 4th 655, 659 (2000) regarding public contracts). The statutes which prohibit such activity are California Government Code sections 1090 and 87100.[1] Section 87100 is part of the PRA (sections 81000 through 91014),[2] which governs all governmental decisions. Section 1090 governs conflict of interest issues regarding public officials entering into contracts for services or other matters, and will be reviewed in this memorandum because an argument might arise that the SDCERS is a “contract” between the City and retirement plan members, and any voting on changes to benefits amends the contract, thereby violating section 1090.

A. Political Reform Act

[1] All statutory code section references and citations are to the California Government Code unless otherwise indicated.

[2] The California Fair Political Practices Commission (FPPC) is the state agency which enforces the PRA. The FPPC has promulgated regulations in Title 2 of the California Code of Regulations (“CCR”) interpreting enforcement of the PRA.

Section 87100 states: "No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has a reason to know he has a financial interest." A "public official" includes "every member, officer, employee or consultant of a state or local government agency . . . ." Section 82048. "Local government agency" is defined in section 82041 as "a county, city or district of any kind . . . or any department, division, bureau, office, board, commission or other agency of the foregoing." Therefore, the Mayor and Council members are "public officials."

Generally, a public official makes a "governmental decision" when the official, acting within the authority of his or her office or position, votes on a matter, obligates or commits his or her agency to any course of action, or enters into any contractual agreement on behalf of his or her agency. 2 CCR § 18702.1. Therefore, a Council member's vote is a governmental decision.

(1) Financial interest

Based on the facts of this memorandum, a public official has a financial interest in a governmental decision under the PRA

> if it is *reasonably foreseeable* that the decision will have a *material financial effect*, distinguishable from its effect on the public generally, on the official, a member of his or her immediate family, or *on any of the following*:
> . . . .
> (c) *Any source of income*, except gifts or loans by a commercial lending institution . . . aggregating five hundred dollars ($500) or more in value provided or promised to, received by the public official within 12 months prior to the time when the decision is made.
> . . . .
> For purposes of this section, indirect investment or interest means any investment or interest owned by the spouse or dependent child of a public official . . . .

Section 87103 (emphases added). The question which arises is: Is the SDCERS retirement pension plan a source of income to the public official? If it is, it is reasonably foreseeable the public official would have a financial interest in the decision, and a conflict of interest would exist. As you will see from the analysis below, the pension plan is not considered income, thus a disqualifying financial interest under section 87100 does not exist.[3]

(a) "Income" generally

[3] If, however, the pension benefit was considered income, a conflict still might not exist through other exceptions set forth in the Regulations such as the "public generally" or "legally required participation" (also known as the "rule of necessity") rules. The "rule of necessity" is discussed later in this analysis. The "public generally" exception is not analyzed in this memorandum because the main question is answered in the statutes themselves.

What is considered "income" under the PRA? Pursuant to section 82030 "income" is:

> (a) [A] payment received, including but not limited to any salary, wage, advance, dividend, interest, rent, proceeds from any sale, gift, including any gift of food or beverage, loan, forgiveness or payment of indebtedness received by the [conflict of interest statement] filer, reimbursement for expenses, per diem, or contribution to an insurance or pension program paid by any person other than an employer, and including any community property interest in the income of a spouse. Income also includes an outstanding loan. . . . "Income," . . . does not include income received from any source outside the jurisdiction . . . .
>
> (b) "*Income" also does not include*:
>
> . . . .
>
> (2) *Salary* and reimbursement for expenses or per diem received *from a state, local, or federal government agency* . . . .
>
> . . . .
>
> (11) *Payments received under a defined benefit pension plan qualified under Internal Revenue Code Section 401(a).*[2]
>
> . . . .
>
> [2] See 26 U.S.C.A. § 401.

(Emphases added.)

(i) <u>A defined benefit plan is not "income"</u>

Subsection (b)(11) of section 82030 excludes from the definition of "income" payments received under a defined benefit pension plan qualified under Internal Revenue Code section 401(a). Since the SDCERS qualifies as such, it is not a source of income to Council members, and thus no disqualifying conflict exists.

(ii) <u>Salary from local government agency is not "income"</u>

Another exception to the definition of "income" is subsection (b)(2), which provides that a salary from a local government agency is not income. The FPPC has opined on this issue as to a retirement plan and states that a retirement benefit such as a pension plan is a "deferred salary payment," and as such, is included in the term "salary" as used in subsection (b)(2). *In re Moore*, 3 FPPC Ops. 33, 36 (1977). The *Moore* opinion has been sustained by the FPPC in several recent advice letters,[4] and has not been overturned by a court.

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[4] For example: *In re Cosgrove*, FPPC Priv. Adv. Ltr. A-98-145; *In re Cannella*, FPPC Priv. Adv. Ltr. A-94-089; *In re Hensley*, FPPC Priv. Adv. Ltr. A-92-525; *In re Whittier*, FPPC Inf. Adv. Ltr. I-92-273; *In re Kuyper*, FPPC Priv. Adv. Ltr. A-88-348.

In deciding this matter, the FPPC looked to a statement by the California Supreme Court in *Waite v. Waite*, 6 Cal. 3d 461, 469 (1972), *overruled on other grounds by In re Marriage of Brown*, 15 Cal. 3d 838, 844 (1976), *superseded by statute on other grounds as stated in In re Marriage of Colvin*, 2 Cal. App. 4th 1570, 1575 (1992). *Waite* involved the division of community property in which a spouse's retirement benefits were sought. The Court in *Waite* stated that "pension benefits do not represent the beneficient [sic] gratuities of the employer; they are, rather, part of the consideration earned by the employee." *Id.* (citing *Sweesy v. L.A. County Peace Officers' Retirement Board*, 17 Cal. 2d 356, 359-60 (1941)). The Court further stated, "the pension payment serves as a remuneration for services rendered by the employee; . . . ." *Id.* at 471. The FPPC interprets this to mean that a pension is a "deferred salary payment," and that a pension is then included in "salary" as that word is used in section 82030(b)(2). *Moore*, 3 FPPC Ops. at 36. Thus, because the pension is considered a salary from a local government agency, it is not income and is therefore not a disqualifying financial interest, so a conflict would not exist.

(b) <u>Spouse or child's interest</u>

Pursuant to the last paragraph of section 87103, financial interest includes any indirect investment or interest owned by a spouse or dependent child. An argument might also arise that a Council member has a financial interest because of his or her parental or spousal relationship to another City employee who is also part of the SDCERS. The same analogy discussed above as to income pursuant to section 82030(b)(2) and the salary exclusion would apply here, since the City employee spouse or child affected by the pension plan would also be receiving a salary from a local government agency.

B. California Government Code section 1090

Another conflict of interest statute which must be reviewed is Government Code section 1090. Section 1090 states in part: "Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members. . . ." The objective of section 1090 is to

> [prohibit government officials] "from being financially interested in any contract made by them in their official capacity or by the body or board of which they are members [and] to insure absolute loyalty and undivided allegiance to the best interest of the [government agency] they serve and to remove all direct and indirect influence of an interested officer as well as to discourage deliberate dishonesty. . . ."

Thorpe, 83 Cal. App. 4th at 659 (citations omitted). Further:

> Under section 1090, the mere presence of one member on a board with a financial interest in a transaction is sufficient to invalidate the transaction even if the member has not voted on the matter or participated in the discussions leading up to the vote. Thus, when it applies, section 1090 effectively disqualifies the entire board from acting.

Finnegan v. Schrader, 91 Cal. App. 4th 572, 581-82 (2001).

Thus, as stated above, an argument could arise that the SDCERS is a "contract" between the City and retirement plan member. Although the original ordinance, or for argument's sake, "contract," was not enacted by any of the present council members, the question which arises is: Does voting on changes which amend the benefits of that "contract" by present or subsequent council members violate section 1090? No, because the "rule of necessity" allows Council to vote without creating a disqualifying financial interest.

(1) "Rule of necessity" under section 1090

Pursuant to *Finnegan*, the "rule of necessity" was "developed originally at common law, [and it] allows public officials to take actions they would otherwise be disqualified from taking by operation of conflict of interest rules if their disqualification would make it impossible for the public agency to fulfill one of its vital public duties." *Id.* at 581; *see also* 70 Op. Cal. Att'y Gen. 45, 48 (1987).

One of the cases most cited as authority for the common law rule of necessity is *Caminetti v. Pacific Mutual Life Ins. Company of California*, 22 Cal. 2d 344 (1943). In *Caminetti*, the California Insurance Commissioner caused a reorganization of a company

pursuant to statutory authority in the Insurance Code. The commissioner had interest holdings in this company. Other intricate holding and interest issues were also involved in the case. An appellate court upheld the entire reorganization pursuant to the statutory authority provided the commissioner. During this reorganization, a trust agreement was entered into through the commissioner between the reorganized company, certain voting trustees, and the state. Because the commissioner owned interest in the reorganized company, certain voting trust issues were challenged under Political Code section 920, the predecessor to Government Code section 1090 (65 Op. Cal. Att'y Gen. 305, 309 (1982)). The Court held the commissioner's voting authority valid and not a conflict. The Court stated:

> If the commissioner were disqualified to act with respect to delinquent insurers in which he holds policies, such insurers and their creditors and policyholders would be deprived of many benefits of the [Insurance] code. No other officer is authorized to perform the commissioner's duties, and if he cannot act, his agents or deputies would likewise be disqualified. In such a situation it must be assumed that the Legislature intended that the commissioner act regardless of the possibility that he might hold policies in the delinquent company. As said in 42 American Jurisprudence 312 "there is an exception, based upon necessity, to the rule of disqualification of an administrative officer. An officer, otherwise disqualified, may still act, if his failure to act would necessarily result in a failure of justice."

Caminetti, 22 Cal. 2d at 366.

Another case frequently cited as to the common law rule of necessity in conflict of interest issues is *Gonsalves v. City of Dairy Valley*, 265 Cal. App. 2d 400 (1968). In *Gonsalves*, a writ of mandate was filed challenging on several bases the city council's issuance of a special use permit which would allow the establishment of a fertilizer plant. One of the allegations was that since each council member held stock in the company to which the permit was granted, they were disqualified to act upon the application of the permit, and that because they did act, their actions were "arbitrary, capricious or fraudulent" and "void and subject to annulment." *Id.* at 404. The court found for the city and stated:

> The rule is well settled that where an administrative body has a duty to act upon a matter which is before it and is the only entity capable to act in the matter, the fact that the members may have a personal interest in the result of the action taken does not disqualify them to perform their duty. It is a rule of necessity which has been followed consistently.

Id. Although section 1090 was not specifically alleged as a cause of action in *Gonsalves*, the court applied the common law rule of necessity to the alleged conflict of interest. What is especially notable about this case is that the fact scenario involved the entire city council, as does the fact scenario at issue in this memorandum.

One of the most recent cases to discuss section 1090's rule of necessity is *Eldridge v. Sierra View Local Hospital Dist.*, 224 Cal. App. 3d 311 (1990).[5] In *Eldridge*, the court reviewed whether or not section 1090 prohibited Eldridge, a hospital district employee, from sitting on the board while in the employ of the district. Other statutes and regulations specific to *Eldridge* but inapplicable to our fact scenario were also reviewed along with the prohibitions of section 1090. The court held that Eldridge could sit on the board because she was not an officer of another board, but only an *employee* of the district. The court noted, however, that if any matter came up for vote before her regarding her contract of employment, or any change to her employment relationship by promotion or modification of benefits, she would be prohibited from voting pursuant to section 1090. In most cases, the board would also be disqualified pursuant to section 1090 from voting. The court stated, however, that in this case "'the rule of necessity' would come into play to allow the making of contracts [by the board that] section 1090 would otherwise proscribe" because a quorum of the board's vote on employment contracts was a necessity. *Id.* at 321-22. Thus, the entire board was not disqualified from voting on employment contract issues because of Eldridge's interest. The court stated:

> The rule of necessity provides that a governmental agency may acquire essential goods or services despite a conflict of interest, and in nonprocurement situations it permits a public officer to carry out the essential duties of his/her office despite a conflict of interest where he/she is the only one who may legally act. The rule ensures that essential government functions are performed even where a conflict of interest exists.

Id. at 321.

(a) <u>Rule of necessity applied here</u>

Pursuant to the Charter, Council members are required to act on retirement matters requiring legislative action. For instance, Charter section 141 provided the Council the authority to establish a retirement system, which it did several years ago. Charter section 146, cited previously, provides the Council with authority to enact "any and all ordinances necessary" to "carry into effect" the provisions of Article IX of the Charter. Further, Charter section 144, which provides authority to the SDCERS Board of Administration to administer the system, uses the language that the Board shall be the authority "under such general ordinances as may be

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[5] *Eldridge* is a case which analyzes section 1090 but states in *dicta* that "The rule of necessity has been codified in section 87101 of the Political Reform Act of 1974 and implemented by California Code of Regulations, title 2, section 18701." *Id.* at 322 (footnotes omitted.) However, there is no actual *holding* by a court which states section 87101 is the codification of section 1090's common law rule of necessity. The Attorney General has also opined that section 87101 is the codification of section 1090's rule of necessity 65 Op. Cal. Att'y Gen. 305, 310 n.9 (1982).

adopted *by the Council*" to carry out its duties. (Emphasis added.) Again, reference is made regarding ordinances adopted by Council.

Therefore, the Charter deems that the Council members' votes are required in SDCERS matters. As stated above, Charter section 141 provided Council with the authority to create a retirement system. In order to do that, ordinances had to be enacted because Charter section 13 states that "All legislative action shall be by ordinance except where otherwise required by the Constitution or laws of the State of California." Charter section 15 states "the affirmative vote of a majority of the members elected to the Council shall be necessary to adopt any ordinance, resolution, order or vote; . . ." Following Charter mandates, Council codified, by way of multiple ordinances passed over the years, the SDCERS into SDMC sections 24.0100 through 24.1809 (Article 4). In order for any SDCERS benefit set forth in Article 4 to be modified, the related ordinances must be amended or new ones added to the Article. Therefore, it is *a necessity* that Council members vote on these matters. Thus, the "rule of necessity" comes into play. As stated in *Gonsalves* quoted above:

> The rule is well settled that where an administrative body has a duty to act upon a matter which is before it and is the only entity capable to act in the matter, the fact that the members may have a personal interest in the result of the action taken does not disqualify them to perform their duty. It is a rule of necessity which has been followed consistently.

Gonsalves, 265 Cal. App. 2d at 404. Therefore, because it is necessary, Council members voting on amendments to benefits of the SDCERS "contract" does not violate section 1090.

C. City Council policy/administrative regulation

While not binding, it is worth analyzing San Diego City Council Policy 000-04 (entitled "Code of Ethics and Ethics Training") and Administrative Regulation 95.60 ("Conflict of Interest and Employee Conduct") since an argument might be raised that even if no conflict exists under the PRA or section 1090, one might exist under the City's own ethics policies. This argument, however, is easily refuted.

Council Policy 000-04 states:

> No elected official, officer, appointee or employee of the City of San Diego shall engage in any business or transaction or shall have any financial or other *personal* interest, direct or indirect, which is incompatible with the proper discharge of his or her official duties or would tend to impair his or her independence or judgment or action in the performance of such duties.

Id. at 1 (emphasis added). Section 3.3 of Administrative Regulation 95.60 reads essentially the same. Pursuant to Charter section 117,[6] all elective City officers are City employees, thus both policies apply to Council members.

These City policies are broader than the statutory conflict of interest provisions previously discussed because they prohibit *personal* interests as well as financial. Although pursuant to the above discussions, a Council member does not have any financial interest disqualifying him or her from voting on pension matters under the PRA, nor does a Council member have a disqualifying financial interest under section 1090 because of the rule of necessity, he or she does have a *personal* interest in the SDCERS pension plan. In many situations where a personal interest exists, a public official can recuse himself or herself from voting in order to comply with the policies. In this instance, however, all Council members have personal interests in the SDCERS, yet, as already discussed, it is necessary for a majority of Council members to vote in order to pass ordinances amending the SDCERS. Therefore, not only would the common law rule of necessity apply, but in addition, the PRA codified rule of necessity, also known as the "legally required participation rule," would also apply as discussed below.

(1) PRA "rule of necessity"

The "rule of necessity" under the PRA refers to section 87101 (*see generally*, *Brown v. FPPC*, 84 Cal. App. 4th 137 (2000); *Kunec v. Brea Redevelopment Agency,* 55 Cal. App. 4th 511 (1997)). The term "legally required participation" is interchangeable with "rule of necessity," and came from an older heading to section 87101 which is no longer used. Section 87101 states:

> Section 87100 does not prevent any public official from making or participating in the making of a governmental decision *to the extent his participation is legally required for the action or decision to be made.* The fact than an official's vote is needed to break a tie does not make his participation legally required for purposes of this section.

(Emphasis added.) As stated above in the PRA discussion, a Council member is not prevented by section 87100 from voting on retirement matters because no disqualifying financial interest exists. Setting aside for argument purposes the fact that section 87100 allows a Council member's participation in voting because of the discussed exceptions, the "rule of necessity" set

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[6] Charter section 117 states in part:
Employment in the City shall be divided into the Unclassified and Classified Service.

(a) The Unclassified Service shall include:

(1) All elective City Officers

forth in section 87101 states that even if 87100 did prevent the participation, if the participation was *legally required*, a section 87100 disqualification would then be excepted.

The regulation interpreting section 87101 is 2 CCR section 18708. This regulation states:

> (a) A public official is not legally required to make or to participate in the making of a governmental decision within the meaning of Government Code section 87101 *unless there exists no alternative source of decision consistent with the purposes and terms of the statute authorizing the decision.*
> (b) Whenever a public official who has a financial interest in a decision is legally required to make or to participate in making such a decision, he or she shall state the existence of the potential conflict as follows:
> . . . .
> (c) This regulation shall be construed narrowly, and shall:
> (1) Not be construed to permit an official, who is otherwise disqualified under Government Code section 87100, to vote to break a tie.
> . . . .

(Emphasis added). No "alternative source of decision consistent with the purposes and terms of the statute authorizing the decision" exists because, as set forth above, the Charter requires that Council members take action on these matters. Therefore, the Charter deems that Council members' participation is *legally required.* Thus, the "rule of necessity" under both the PRA and section 1090 would refute an argument that the City does not comply with its own conflict of interest policies (Council Policy 000-04; Administrative Regulation 95.60).[7]

CONCLUSION

Council members are not disqualified from voting on ordinances which affect the SDCERS. In order for a disqualifying conflict of interest to exist, a Council member must have a financial interest in the voting decision. Under the PRA, neither a Council member's salary as a City employee nor the right to a City pension qualifies as "income," such that either would constitute a disqualifying financial interest. Even if a financial interest did exist, the "rule of necessity" under the PRA would permit the Council member to vote as is legally required under the Charter. Further, no conflict exists under section 1090 because the common law rule of necessity is applicable as well.

CASEY GWINN, City Attorney

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[7] As a side note, the requirement in 2 CCR section 18708(b) to state on the record the existence of a potential conflict if one exists (e.g., when a public official has a *financial* interest in the decision), would not apply here for the reasons previously discussed in the analysis of section 87100.

By

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